NTCA
NATIONAL TELECOMMUNICATIONS COOPERATIVE ASSOCIATION
The Voice of Rural Telecommunications
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September 18, 2008

Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, SW, TW-A325
Washington, D.C. 20554

***Ex Parte* Notice: *In the Matter of Developing a Unified Intercarrier Compensation Regime,* CC Docket No. 01-92; and *IP-Enabled Services,* WC Docket 04-36.**

Dear Ms. Dortch:

On Thursday, September 18, 2008, Scott Reiter and Daniel Mitchell with the National Telecommunications Cooperative Association (NTCA), met with Commissioner McDowell's Legal Advisor Nicholas Alexander to discuss issues raised in the above referenced dockets. Specifically we discussed the August 6, 2008 inter-carrier compensation proposal submitted by a coalition, which includes AT&T, Verizon and others, and the follow-up filing of AT&T and Verizon on September 12, 2008, urging the Federal Communications Commission (FCC or Commission) to establish a mandatory unified $0.0007 terminating access rate[1] for all price cap and rate-of-return (RoR) carriers. The proposal further states that the Commission should apply the proposed universal $0.0007 terminating access rate to all traffic, to all carriers, and in all jurisdictions.

We first briefed Nicholas on the legal impediments face by Verizon and AT&T in attempting to apply a mandatory unified $0.0007 terminating access rate to all traffic, in all jurisdictions, to all carriers, which include:

1. Unlawful Preemption of State Jurisdiction under Section 2 of the Communications Act of 1934, as Amended (Act) (47 U.S.C. Section 152),

2. Violation of the State and Federal Separations Requirements under Section 410 of the Act (47 U.S.C. Section 410),

3. Violation of the Regulatory Compact under RoR Ratemaking - FCC and State Commissions have approved RoR Rural LEC access costs and rates as just, reasonable and prudent,

4. Unlawful Takings under the 5th Amendment of the United States Constitution, Confiscation of rural RoR carrier property, and

5. Fails to consider and recognize that separate rules and rates should apply to small rural RoR carriers in accordance with the Regulatory Flexibility Act, 5 U.S.C. Sections 601 - 612.

[1] In discussions with the coalition sponsors, NTCA learned that the $0.0007 terminating rate was for switching only and does not include compensation for terminating transport.

NTCA[2] specifically urged that the Commission reject the proposed unified $0.0007 terminating access rate because it will significantly harm rural consumers, unlawfully preempt the states, and result in an unlawful taking of RoR carrier property. Unlike price cap carriers whose switched access, transport and transiting rates are non-cost-based, RoR carrier switched access, transiting, and transport rates are cost-based and are approved by the FCC and state commissions and allocated to the interstate and intrastate jurisdictions under the FCC's federal/state separations rules pursuant to Sections 2 and 410 of Act. The proposed unification of all terminating interstate, intrastate, and local/reciprocal compensation access rates to a ***non-cost-based rate of $0.0007*** per minute for RoR carriers, therefore, would violate federal and state approved cost-based rate-of-return ratemaking and separations requirements under Section 410 of the Act, violate the States authority to set intrastate rates under Section 2 of the Act, and violate the takings clause in the 5th Amendment of the United States Constitution. The coalition proposal would be extremely harmful to rural consumers served by RoR carriers.

We then urged the Commission to reject the coalition proposal and instead adopt the following NTCA proposed measures for RoR carriers which will safeguard rural consumers from significant rate increases, allow for a lawful and orderly transition to comprehensive inter-carrier compensation (IC) and universal service fund (USF) reform, and create the proper incentives and regulatory environment for carriers to invest in broadband in rural, high-cost areas throughout the United States.[3]

1. **For RoR carriers, the Commission should cap *interstate* access rates at their current cost-based levels in accordance the *NTCA Interim USF & IC Reform Proposal filed with the FCC on July 11, 2008.*[4] RoR carrier *intrastate* access, reciprocal compensation, transiting, and transport rates should remain unchanged, unless separations changes are adopted by the Commission to reflect the proper reallocation of intrastate costs to the interstate jurisdiction. Unlike the coalition proposal, the NTCA plan does not preempt state jurisdiction to establish intrastate access rates under Section 2 of the Act (47 U.S.C. §152), and maintains RoR carrier cost-based access rates which prevent an unlawful taking of RoR carrier property**.[5]

[2] NTCA is a premier industry association representing rural telecommunications providers. Established in 1954 by eight rural telephone companies, today NTCA represents 585 rural rate-of-return regulated telecommunications providers. All of NTCA's members are full service rural local exchange carriers (rural LECs) and many of its members provide wireless, cable, Internet, satellite and long distance services to their communities. Each member is a "rural telephone company" as defined in the Communications Act of 1934, as amended (Act). NTCA's members are dedicated to providing competitive modern telecommunications services and ensuring the economic future of their rural communities.

[3] The FCC does not have statutory authority to mandate the price of intrastate access charges and local reciprocal compensation rates. The States have been given the explicit statutory authority to set intrastate rates under Section 2 of the Act. NTCA supports the voluntary reduction of state access rates by state commissions so long as RoR carriers receive revenue neutral access replacement universal service support, after applying a federal local rate benchmark, to offset access revenue losses as a result of intrastate access rate reductions in order to continue to deploy, maintain, and operate their voice and broadband networks.

[4] *See, NTCA Interim USF & IC Reform Plan*, filed on July, 11, 2008, in CC Docket No. 96-45, CC Docket No. 01-92, and WC Docket No. 05-337. The NTCA Interim USF & IC Reform Plan does not address intrastate access because of the jurisdictional issues that would be presented.

[5] See, *Covington & L Turnpike Road Co. v. Sandford*, 164 U.S. 578, 597 (1896), *Bluefield Water Works v. Public Service Commission* 262 U.S. 679 (1923), *Smith v. Illinois*, 282 U.S. 133, 51 S. Ct. 65 (1930), *Federal Power Commission v. Natural Gas*

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The Commission has recognized the unique characteristics of rural RoR carriers, their dependence on access charge revenues, and the need to preserve universal service in the *MAG Order*, stating that "Our examination of the record reveals that rate-of-return carriers generally are more dependent on their interstate access charge revenue streams and universal service support than price cap carriers and, therefore, more sensitive to disruption of those streams. . . . . The approach that we adopt will provide these carriers with certainty and stability by ensuring that the access charge reforms we adopt do not affect this important revenue stream."[6] The Commission and the Joint Board have recognized that RoR regulation along with the universal service fund have worked well in rural areas, not only for providing quality service at reasonable rates but also for deploying broadband in rural areas.[7]

NTCA's proposed cap on RoR carrier interstate switched access rates will ensure that RoR carrier rates do not continue to increase, which will benefit multiple parties.[8] Interexchange carriers (IXCs), such as AT&T and Verizon, and interconnected voice over Internet Protocol (VoIP) providers, will benefit significantly by paying lower access charges than they otherwise would if RoR carrier access charges were not capped. Since IXCs can pass on access costs in their retail long-distance rates to consumers, consumers may also benefit by paying lower retail long-distance rates, assuming AT&T, Verizon, and other IXCs pass these savings to their customers. More importantly, rural consumers served by RoR carrier will continue to receive the high-quality service and will benefit by rural RoR carriers' continued investment in broadband infrastructure.

Unlike the coalition proposal, NTCA's proposal does not unlawfully preempt the states. The Supreme Court recognized the important role states play to avoid issues of preemption and confiscation. The Court stated that, "proper regulation of rates can be had only by maintaining the limits of state and federal jurisdiction."[9] Congress obviously intended that state and federal representatives work together, make compromises and negotiate something that would work for both the federal government and the states. The application of the coalition mandatory $0.0007 proposal to RoR carriers would undermine Congress's intent to have the FCC work with the states to determine the proper allocation of access costs between the federal and state jurisdictions.

Pipeline Co., 315 U.S. 575, 585 (1942), *Federal Power Commission, et al. v. Hope Natural Gas Co., et al.*, 320 U.S. 591 (1944), *Federal Power Commission v. Texaco, Inc.*, 417 U.S. 380, 391-92 (1974), and *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307-308 (1989).

6 *See In the Matter of Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers, Second Order and Further Notice of Proposed Rulemaking*, FCC Docket No. 01-304, (rel. October 11, 2001) ("*MAG Order*"),¶ 131.

7 *MAG Order*, ¶ 224 and *See In the Matter of High-Cost Universal Service Support, Federal-State Joint Board on Universal Service Recommended Decision*, WC Docket No. 05-337, CC Docket No. 96-45, FCC 07J-4, released November 20, 2007 ("Federal-State Joint Board Recommended Decision"), ¶¶ 30 and 39.

8 As a point of clarification in the NTCA interim proposal, for the National Exchange Carrier Association (NECA) pool, the cap would reflect the composite pool average switched access rate level. NECA would continue to have the ability to assign pool study areas to rate bands as it does currently.

9 *Smith v. Illinois*, 282 U.S. 133, 51 S. Ct. 65 (1930).

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Moreover, utilities, such as RoR carriers, are protected from the unlawful taking of their property by the 5th Amendment of the United States Constitution.[10] This protection extends to a prohibition on the setting of confiscatory rates that result in a taking of property. The Commission has consistently recognized its statutory responsibility and has regulated in a manner that allows RoR carriers to recover their costs along with a reasonable return on investment.[11] The Commission has also recognized the unique characteristics of rural RoR carriers and the unique challenges they face in providing quality service to their customers.[12]

Pursuant to the 5th Amendment,[13] Sections 201 and 254 of the Act, and existing regulatory precedent,[14] the Commission has a legal responsibility to provide rates and a rate structure for rural RoR carriers that does not result in a confiscatory taking and will provide an opportunity to recover costs as well as earn a reasonable return on those investments made to provide service.[15] The Commission has previously recognized this responsibility, specifically stating that "[r]ate-of-return carriers charge rates that are designed to provide the revenue required to cover costs and to achieve a prescribed return on investment."[16] In exchange for a reasonable opportunity to recover costs including a reasonable return, RoR carriers have provided quality service at rates reasonably comparable to those in urban areas to **all** rural consumers in the areas they serve, and have fulfilled all carrier of last resort (COLR) obligations.[17] NTCA therefore urges the Commission to reject the coalition proposal and adopt the measures proposed by NTCA which allow the FCC to achieve its statutory goals and avoid violating federal and state approved cost-based rate-of-return

[10] Courts have long evaluated utility rates against the back drop of the requirements of the Constitution and confiscatory rates, i.e., *Bluefield Water Works v. Public Service Commission* 262 U.S. 679 (1923) and *Federal Power Commission, et al. v. Hope Natural Gas Co., et al.*, 320 U.S. 591 (1944). It is clear that "[t]he Constitution protects utilities from being limited to a charge for their property serving the public which is so 'unjust' as to be confiscatory." *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307-308 (1989) (citing *Covington & L Turnpike Road Co. v. Sandford*, 164 U.S. 578, 597 (1896) (A rate is too low if it is "so unjust as to destroy the value of [the] property for all the purposes for which it was acquired," and in so doing "practically deprive[s] the owner of property without due process of law"); *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585 (1942) (summary omitted.); *Federal Power Commission v. Texaco, Inc.*, 417 U.S. 380, 391-92 (1974)) (summary omitted).

[11] *See In the Matter of Federal State Joint Board on Universal Service, CC Docket No. 96-45, FCC 01-157, Fourteenth Report & Order*, (May 23, 2001) ("*RTF Order*"), ¶¶ 24 and 25, and *See MAG Order*, ¶¶ 3, 12, 131, 132, and 134.

[12] *RTF Order*, ¶¶ 24, 25, and 79, and *MAG Order*, ¶¶ 3, 12, 131, 132, and 134.

[13] United States Constitution, Amendment V.

[14] *RTF Order*, ¶¶ 24 and 25. See also, *MAG Order*, ¶¶ 3, 12, 131, 132, and 134.

[15] See *F.C.C. v. Florida Power Corp*. 480 U.S. 245, 253-254 (1987).

[16] *MAG Order*, ¶19.

[17] See, discussion of *Federal Power Commission v. Hope Natural Gas*, 320 U.S. 591 (1944) in Duquesne at 310. "Today we reaffirm these teachings of Hope Natural Gas: "[I]t is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unreasonable, judicial inquiry ... is at an end. The fact that the method employed to reach that result may contain infirmities is not then important." Id., at 602, 64 S.Ct., at 288. This language, of course, does not dispense with all of the constitutional difficulties when a utility raises a claim that the rate which it is permitted to charge is so low as to be confiscatory: whether a particular rate is "unjust" or "unreasonable" will depend to some extent on what is a fair rate of return given the risks under a particular rate-setting system, and on the amount of capital upon which the investors are entitled to earn that return. At the margins, these questions have constitutional overtones."

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ratemaking requirements, the States' authority to set intrastate rates under Section 2 of the Act, and the takings clause in the 5th Amendment of the United States Constitution.

2. **Any interstate access costs not recovered as a result of capping RoR carrier interstate access rates should be recovered through Interstate Common Line Support (ICLS) after applying a federal local benchmark, as conceptually defined in the *Missoula Plan Addendum* in CC Docket 01-92, filed on February 20, 2007. The federal local rate benchmark would include the RoR carrier's basic local voice rate, federal subscriber line charge (SLC), and the State's per-line USF monthly assessment. Such a federal benchmark could be imputed.**

NTCA's proposal to recover residual access costs resulting from the capping of interstate RoR carrier access rates at their current cost-based levels from the ICLS after applying a federal local benchmark for RoR carriers is sound public policy, which builds on the record established in the Commission's *MAG Order*.[18] Since supplemental support in the NTCA proposal is limited solely to RoR carriers, which represent a small portion of the nation's access lines relative to price cap carriers, such a change will not result in large increases in the USF. Indeed, recently in its *CETC Cap Order*, the Commission observed that ICLS for RoR carriers has been stable in recent years.[19] Thus, the stability in the size of ICLS for incumbent LECs that the Commission anticipated seven years ago in the *MAG Order* has occurred. This stability should continue under the adoption of the NTCA Interim USF & IC Reform Proposal.

3. **Any access replacement support received by a price cap carrier should be offset by access expense savings the carrier's long-distance affiliate receives.**[20]

The cost reductions through lower terminating access rates paid by price cap carriers through their long-distance affiliates should be used to offset any access replacement support received by price cap carriers. Price-cap carriers, such as AT&T and Verizon, should not receive windfalls as a result of access rate changes. Furthermore, the impact of intercarrier compensation reform on the size of the universal service fund should be as minimal as possible, as would be accomplished by accounting for the access savings realized by these companies.

4. **If the Commission determines that it has legal authority to set a price cap carrier non-cost-based terminating switched access rates at $0.0007 per minute because price cap carrier rates are already non-cost-based, then the Commission must also apply the non-cost-based $0.0007 per minute rate to all price cap carrier switching, including tandem transit service.**

The tandem transiting rate proposed in Step 2 of the Missoula Plan capped the tandem transit service rate for price cap carriers at $0.0025 per minute, and allowed this rate to increase annually by inflation at Step 5.[21]

[18] In the *MAG Order*, the Commission also observed that ICLS will be constrained by carriers' embedded costs and recalculated annually to recoup any unrecovered costs. See *MAG Order*, ¶¶ 133-134.

[19] See In the Matter of High-Cost Universal Service Support (WC Docket No. 05-337) and In the Matter of Federal-State Joint Board on Universal Service, ¶ 10 (CC Docket No. 96-45), (rel. May 1, 2008) ("*CETC Cap Order*").

[20] *See the Sprint Ex Parte Letter* filed in CC Docket No. 01-92, and WC Docket No. 04-36, footnote 2, August 7, 2008.

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Since the price cap carriers who signed onto the coalition letter believe that a local switching rate of $0.0007 per minute is adequate, it then follows that transiting rates, a similar switching function, should also be set at $0.0007 per minute.[22] Moreover, the volume of minutes traversing a tandem switch is much higher than that of a local central office switch, therefore that the Commission could set price cap tandem transiting rates at levels much lower than $0.0007 per minute. Reducing price cap carrier tandem transiting rates below $0.0007 per minute would provide further savings for IXCs, VoIP providers, and consumers.

5. All large, vertically-integrated communications carriers, such as AT&T and Verizon, should be required to provide non-discriminatory, cost-based special access transport services needed to reach the Internet backbone.

Increasing special access transport costs to the Internet backbone can harm rural consumers and RoR carriers and the problem worsens when those carriers must purchase special access services from large vertically integrated companies to connect their customers to the Internet backbone.[23] These costs as well as the IP costs associated with the middle mile[24] and the Internet backbone itself are significant costs of providing broadband service in rural areas and must be addressed in any comprehensive reform.[25] To achieve and maintain the goal of universal affordable broadband service for all Americans, the Commission should regulate the terms, conditions and prices of Internet backbone services, including special access transport needed to reach the Internet backbone, to ensure that large, vertically-integrated Internet backbone providers do not abuse their market power by imposing unfair and discriminatory pricing on small, rural communications carriers providing retail high-speed Internet access service in rural, insular and high-cost areas of the United States. The FCC has already adopted some of these conditions as part of the FCC's approval of the AT&T/BellSouth merger.[26] NTCA urges the FCC to broaden these conditions in the future.

[21] See the July 18, 2006, Executive Summary of The Missoula Plan, pages 11 and 12, filed in CC Docket 01-92.

[22] Transiting includes tandem transit service which is a switched transport service provided by a third party carrier using its tandem switch to effectuate indirect interconnection between two carriers within a local access transport area (LATA)(or in Alaska, within a local calling area). Tandem transit service also includes both tandem switching and tandem switched transport (also called common transport), or the functional equivalent, between the transit tandem location and the edge of a terminating carrier's network. Where the terminating carrier is an ILEC and the tandem transit provider interconnects with the ILEC at a meet point, tandem transit service stops at that meet point.

[23] Federal-State Joint Board Recommended Decision, p. 15.

[24] National Exchange Carrier Association (NECA), *Middle Mile Broadband Cost Study*, October 2001. NECA's findings were dire—concluding that high-speed Internet service is uneconomic in many rural areas. NECA further found that increased IP traffic will exacerbate, rather than ameliorate, the problem, as existing revenue shortfalls are multiplied as the scale of operations increases. For example, the study shows revenue shortfalls at $9.7 million per year at a 0.5% penetration rate, growing to $33.6 million per year at a 5% penetration rate, $49.8 million at a 10% penetration rate, and $63.8 million per year at a 15% penetration rate. NECA's sobering conclusion: "high-speed Internet service may not be sustainable in many rural areas based on pure economics. *See NECA Middle Mile Cost Study Executive Summary*, www.neca.org/source/NECA_Publications_1154.asp.

[25] Special access transport includes, among other services, packet-switched broadband services, optical transmission services (e.g., frame relay, ATM, LAN, Ethernet, video-transmission, optical network, wave-based, etc.), TDM-based services (e.g., DS-1, DS-3, etc.), and other future transport services to reach the Internet backbone.

[26] *In the Matter of A&T and BellSouth Corporation Application for Transfer and Control*, Order on Reconsideration, Appendix, Page 5, WC Docket No. 06-74, (rel. March 26, 2007).

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Conclusion:

Based on the above reasons, the Commission should reject the proposed unified $0.0007 per minute terminating access rate. RoR LECs are making good on their promise to deliver broadband services to rural areas.[27] RoR LECs have made significant investments in the rural high-cost portions of America under an existing universal service support system that allows for recovery of a sufficient portion of a carrier's embedded costs of total regulated facilities. If these costs are no longer recovered through access charges and/or universal service, and an alternative recovery method is not available or is prohibited by regulators, then these costs will become stranded investment.[28] As Commissioner Copps stated:

> [i]t is essential, that any regime we adopt increase certainty so that rural carriers can plan for the future and undertake necessary investment to modernize the telecommunications infrastructure in their communities.[29]

Given the Act's goal of preserving and advancing universal service to ultimately provide consumers with access to advanced telecommunications and information services, failure to address stranded cost would be completely at odds with the intent of Sections 254 and 706 of the Act.

Lastly, the Regulatory Flexibility Act (5 U.S.C. §601) requires the FCC to consider alternative rules that will reduce the economic impact on small entities, such as RoR rural carriers. NTCA's USF and IC reform recommendations would reduce the economic impact on small RoR broadband providers and rural consumers. NTCA's proposals would also allow the Commission to meets its regulatory responsibility, promote the public interest, convenience, and necessity, spur development of new advanced communications technologies and broadband deployment, and most importantly ensure that consumers living in rural high-cost areas are able to receive high-quality, affordable voice and broadband services. NTCA therefore urges the Commission to reject the coalition proposal and adopt NTCA's recommendations to make certain consumers living in rural high-cost areas are able to receive high-quality, affordable voice and broadband services.

[27] *NTCA 2007 Broadband/Internet Availability Survey Report,* September 2007, www.ntca.org.

[28] The term "stranded investment" typically means plant facilities that are no longer in use and have not fully recovered their costs. However, in the context of this proceeding, stranded investment can result in plant facilities that are not fully recovering their costs but are still in use.

[29] *In the Matter of the Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers,* CC Docket No. 00-256; *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45; *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation,* CC Docket No. 98-77; *Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers,*(2001)(MAG Order), *Dissenting Statement of Commissioner Michael J. Copps.*

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NTCA's positions discussed are the same as those reflected in previous NTCA filings in these dockets. Pursuant to Section 1.1206 of the Commission's rules, a copy of this letter is being filed via ECFS with your office. If you have any questions, please do not hesitate to contact me at (703) 351-2016.

Sincerely,

/s/ Daniel Mitchell
Daniel Mitchell
Vice President
Legal and Industry

DM:rhb

cc:
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